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S E C R E T STATE 007077

STADIS////////////////////////////////////

EXDIS

FOLLOWING REPEAT LISBON 195 ACTION SECSTATE 12 JAN

QUOTE

S E C R E T LISBON 0195

STADIS

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DEPT PLEASE PASS USMISSION NATO FOR AMBASSADOR CARLUCCI

E.O. 11652: XGDS-3

TAGS: EAID, PFOR, PO, US

SUBJECT: PORTUGUESE ECONOMIC SITUATION

REF: STATE 003254

1. FOLLOWING IS EMBASSY INPUT FOR NSC PAPER REQUESTED REFTEL.
2. IN APRIL 1976, PORTUGAL WILL FACE ITS FIRST FREE ELECTIONS FOR A NATIONAL ASSEMBLY AND PRESIDENT IN 50 YEARS. THE RESULTS WILL SET THE COURSE OF PORTUGUESE POLITICS FOR THE NEXT SEVERAL
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YEARS. IT IS VIRTUALLY CERTAIN THAT THE DEMOCRATIC PARTIES WILL WIN. LESS CERTAIN IS WHETHER PORTUGAL'S FRAGILE NEW DEMOCRACY WILL BE ABLE TO SURVIVZ DETERMINED EFFORTS OF WELL-DISCIPLINED COMMUNISTS TO BRING DOWN A CIVILIAN GOVERNMENT.

3. USG TOOK LEADING ROLE IN PROVIDING DEVELOPMENT ASSISTANCE IN CRITICAL PERIOD AFTER APRIL 1974. ALTHOUGH RELATIVELY SMALL, OUR AID:

- ENCOURAGED DEMOCRATIC FORCES TO BELIEVE THEY COULD COUNT UPON SUPPORT FROM THE WEST.
- STRENGTHENED THE HAND OF NON-COMMUNISTS IN 1975 CONSTITUENT ASSEMBLY ELECTIONS.
- INCREASED SELF-CONFIDENCE OF DEMOCRATIC FORCES, THEREBY CONTRIBUTING TO VICTORY OVER PRO-COMMUNIST ATTEMPTED COUP OF NOVEMBER 25.

4. IN PERIOD FOLLOWING 1976 ELECTIONS, A DEMOCRATIC GOVERNMENT WILL MORE THAN EVER NEED CONCRETE ASSURANCES TO:

- ASSIST GOVERNMENT TO WITHSTAND INCREASING PRESSURES FROM THE LEFT WHILE IMPLEMENTING NECESSARY AUSTERITY MEASURES.
- ENABLE GOVERNMENT TO EASE SERIOUS UNEMPLOYMENT PROBLEM OR, AT LEAST, PREVENT ITS DETERIORATION.

5. SUCCESS OF A DEMOCRATIC, NON-COMMUNIST GOVERNMENT IN PORTUGAL WILL HAVE IMPORTANT INFLUENCE IN REST OF SOUTHERN EUROPE, WITH SPECIAL IMPACT ON NEIGHBORING SPAIN WHICH, LIKE PORTUGAL, IS FACING DIFFICULT POLITICAL TRANSITION. PORTUGUESE DEVELOPMENTS WILL ALSO HAVE IMPORTANT EFFECT ON NATO AND CONTINUED U.S. ACCESS TO STRATEGIC AZORES FACILITIES.

6. ECONOMIC SITUATION: AFTER TWO YEARS OF EXCESSIVE CONSUMPTION, RELATIVE TO OUTPUT, ECONOMY REACHED DISASTROUS SITUATION AT END OF 1975: UNEMPLOYMENT APPROXIMATELY 13 TO 14 PERCENT OF LABOR FORCE AND INCREASING; UNDEREMPLOYMENT UP SHARPLY; PRICES FOR BASIC CONSUMER GOODS RISING AT 20-25 PERCENT ANNUAL RATE, AND PROMISING TO DOUBLE IN 1976; NET FIXED INVESTMENT APPARENTLY AT ZERO OR NEGATIVE RATE; EXPORTS INCREASINGLY NON-COMPETITIVE; AND LABOR ATTITUDES INDICATE CONTINUED LOW PRODUCTIVITY. GIVEN VIRTUAL EXHAUSTION OF PORTUGAL'S LIQUID INTERNATIONAL RESERVES, ECONOMIC DETERIORATION SEEMS CERTAIN TO

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PERSIST IN 1976. UNLESS EMERGENCY MEASURES ARE ADOPTED, CONSUMPTION MAY DECLINE BY 15 TO 20 PERCENT AND UNEMPLOYMENT MAY REACH 17 TO 20 PERCENT. SUCH DEVELOPMENTS WOULD TRAUMATIZE PORTUGUESE PEOPLE ACCUSTOMED TO STABLE CONSUMER PRICES AND JOB SECURITY.

7. REQUIREMENTS FOR RECOVERY: GOP MUST ACT QUICKLY BUT METHODICALLY TO RESTIMULATE ECONOMY. PORTUGAL'S BASIC ECONOMIC NEEDS, IN ORDER OF PRIORITIES, CAN BE SUMMARIZED AS FOLLOWS:

- A LARGE, IMMEDIATE INFUSION OF INTERNATIONAL LIQUIDITY THAT WOULD FACILITATE AN ORDERLY REDUCTION IN CONSUMPTION AND A DIMINISHED IMPACT ON LOWEST INCOME SECTOR. GOLD RESERVES ARE LARGE, BUT ARE PROVING RELATIVELY ILLIQUID OVER SHORT TERM.

LACK OF LIQUID RESERVES WOULD, GIVEN PORTUGAL'S DEPENDENCE ON IMPORTS, CAUSE AN IMMEDIATE, STEEP RISE IN UNEMPLOYMENT AND INFLATION THAT WOULD DESTABILIZE POLITICAL SYSTEM.

-- GOP MUST PROMOTE A SHARPLY AUGMENTED INVESTMENT PROGRAM, VAST MAJORITY OF WHICH MUST NECESSARILY BE PUBLIC SECTOR DURING FORESEEABLE FUTURE. SUCH A PROGRAM, IF UNDERTAKEN WITHIN PRESENT CONTEXT, WOULD QUICKLY RUN INTO BOTH DOMESTIC SAVINGS AND FOREIGN EXCHANGE CONSTRAINTS, ACCELERATING THE INFLATIONARY SPIRAL. PORTUGAL MUST HAVE, THEREFORE, LONG-TERM FOREIGN FINANCING FOR MUCH OF ITS INVESTMENT PROJECTS.

-- GOP MUST REDOUBLE ITS EFFORTS TO ASSURE ADEQUATE FOOD SUPPLIES, THROUGH IMPORTS OVER SHORT-TERM, BUT INCREASINGLY FROM DOMESTIC PRODUCTION OVER LONGER TERM. THUS, IMMEDIATE NEED IS FOR FOOD IMPORT CREDITS AND, SECONDLY, ASSISTANCE TO IMPROVE PRODUCTION AND DISTRIBUTION TECHNIQUES.

-- AN EXTENSIVE IMPROVEMENT IN THE NATION'S TECHNICAL SKILLS. PUBLIC SECTOR MUST PROMPTLY EXPAND ITS HIGHLY LIMITED MANAGERIAL CAPACITY TO MATCH ITS EXPANDED ECONOMIC ROLE.

-- PORTUGAL MUST REVERSE THE DOWNWARD TREND OF ITS EXPORTS. ALTHOUGH BASIC RESPONSIBILITY RESTS WITH GOP, SYMPATHETIC FOREIGN COUNTRIES COULD ASSIST THROUGH THEIR TRADE POLICIES.

I. DOMESTIC REFORM: ABOVE DOES NOT PRETEND TO ENCOMPASS ALL ECONOMIC NEEDS. IT EXCLUDES SUCH NEEDS AS IMPROVED LABOR/MANAGEMENT RELATIONS, RESTRICTIVE WAGE POLICY, PROPER MONETARY/FISCAL MEASURES, AND REALISTIC PRICING SYSTEM. THESE NEEDS, HOWEVER, ARE ESSENTIALLY INTERNAL QUESTIONS IN WHICH FOREIGN SECRET

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GOVERNMENTS HAVE LITTLE DIRECT ROLE. GOP HAS RECOGNIZED IMPORTANCE OF REFORM AND RECENTLY HAS MADE SIGNIFICANT PROGRESS, PARTICULARLY AS REGARDS PRICES. OUR AID MUST BE VIEWED AS SUPPORT FOR IMPLEMENTATION, NOT AVOIDANCE, OF THESE REFORMS.

9. FOREIGN FINANCING: MAGNITUDE OF FOREIGN CREDIT INFLOWS REQUIRED TO FINANCE ECONOMIC REVIVAL IS EXTREMELY LARGE. THESE REQUIREMENTS CAN BE DIVIDED INTO TWO CATEGORIES: (A) SHORT-TERM LIQUIDITY TO COVER B/P DEFICIT RESULTING FROM "NORMAL" ECONOMIC ACTIVITY; (B) INVESTMENT CAPITAL, INCLUDING TECHNICAL ASSISTANCE.

10. SHORT-TERM LIQUIDITY: PORTUGAL APPEARS, LARGELY THROUGH ITS RECENT IMF TRANSACTIONS, TO HAVE GAINED SUFFICIENT LIQUIDITY TO FINANCE ITS DEFICIT UNTIL END OF FEBRUARY. FOR REMAINDER OF 1976, IT WILL REQUIRE ADDITIONAL LIQUIDITY FINANCING OF ABOUT \$1 BILLION. SOURCES FOR THIS FINANCING ARE FEW. CURRENT DISCUSSIONS INDICATE THAT, UNDER BEST OF CIRCUMSTANCES, \$800 MILLION MAY BECOME AVAILABLE. EVEN UNDER THIS HIGHLY OPTIMISTIC FORECAST, PORTUGAL FACES LIQUIDITY SHORTFALL OF SOME \$200 MILLION.

GOLD OPERATIONS 400

IMF CREDIT TRANCHES 60

SPECIAL GERMAN CREDIT 250

USAID 70

(REFUGEE RELIEF - 35)

(FY76 HOUSING GUARANTEE -
20)

(FY76 HOUSING LOAN -
13.25)

(FY 76 TECHNICAL ASSISTANCE -
1.75)

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P.L. 480 15

MISCELLANEOUS BI- 20
LATERAL

TOTAL 815

PROJECTED MARCH- 1,000
DEC. NEEDS

SHORTFALL \$185 MILLION

11. INVESTMENT FINANCING: MASSIVE INVESTMENT PROGRAM SUFFICIENT TO REVERSE ECONOMIC DECLINE AND TO PROVIDE FRAMEWORK FOR POLITICAL STABILITY WOULD WIDEN GAP APPRECIABLY. INVESTMENT PROJECTS WILL HAVE TO COME FROM TRADITIONAL GOVERNMENT SECTOR, NATIONALIZED INDUSTRIES, AND EVENTUALLY PRIVATE SECTOR. FOREIGN EXCHANGE COST IN 1976 WOULD VARY CONSIDERABLY DEPENDING ON TYPE OF PROJECTS, TIME FRAME OF SELECTION/IMPLEMENTATION, WAGE POLICIES, ETC. HOWEVER, ONE CAN EXPECT A MINIMUM REQUIREMENT FOR SOME \$1.2 BILLION IN COMMITTED CREDITS, I.E., AUTHORIZATIONS NOT NECESSARILY OUTLAYS. PART CAN BE EXPECTED FROM PRIVATE SECTOR, ESPECIALLY IF CONFIDENCE OF PRIVATE BANKING SYSTEM IS RESTORED. IN FINAL ANALYSIS, HOWEVER, OFFICIAL AND MULTILATERAL INSTITUTIONS MAY HAVE TO PROVIDE SOME \$700 MILLION OF TOTAL.

12. PRESENTLY INDICATED INVESTMENT CREDITS FROM OFFICIAL AND MULTILATERAL AGENCIES LEAVE A SHORTFALL OF SOME \$250 MILLION, EVEN UNDER HIGHLY OPTIMISTIC ASSUMPTIONS. MANY OF THESE CREDITS, SUCH AS EFTA LOANS, MAY NOT MATERIALIZE THIS YEAR.

EUROPEAN COMMUNITY 180

WORLD BANK 150

EFTA 50

OTHER MULTILATERAL 10

USAID NOW IN CONGRESS 40

(HOUSING GURANTEE - 20)
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KPROJECT LOANS - 20)

OTHER BILATERAL 20

TOTAL 450

PROJECTED NEEDS 700

SHORTFALL \$250 MILLION

13. CLOSING THE GAP: COMBINED LIQUIDITY (\$200) AND INVESTMENT (\$250) SHORTFALLS PROJECTED AT \$450 MILLION. FOLLOWING IS ONE POSSIBLE COMBINATION FOR CLOSING THIS GAP. (NO PROVIEWION MADE FOR OFTEN-EXPECTED ARAB CAPITAL BECAUSE NO FIRM INDICATION EXISTS THAT SUCH FUNDS WILL BE FORTHCOMING. IF THEY DO, POLITICAL STRINGS WOULD PROBABLY BE INIMICAL TO U.S. INTERESTS.):

INCREASED EUROPEAN ASSISTANCE 50

ADDITIONAL IMF CREDIT TRANCHE 60
LOAN

USAID PROGRAM LOAN 20

FY77 P.L. 480 CREDITS 20

EX-IM BANKCREDITS 200

U.S. LIQUID LOAN SIMILAR TO 100
THAT BEING DISCUSSED WITH
GERMANY

TOTAL \$450 MILLION

14. U.S. ROLE: EUROPEANS, NOTABLY EC AND GERMANY, CLEARLY HAVE TAKEN MAJOR LEAD IN OFFERING ASSISTANCE. TIME HAS COME FOR USG TO FOLLOW THIS LEAD, ESPECIALLY SINCE WE EARLIER PROMISED PORTUGAL SUBSTANTIAL AID IF IT TOOK DECISION STEP TOWARD DEMOCRATIC, NON-COMMUNIST GOVERNMENT. BESIDES PROVIDING CREDITS, USG SHOULD AGGRESSIVELY SULPORT GOP EFFORTS TO OBTAIN

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CREDITS FROM OTHER SOURCES. IT CAN HELP ALSO BY URGING PRIVATE BANKERS TO BE MORE FORTHCOMING, BY ENCOURAGING PRIVATE INVESTMENT THROUGH OPIC COVERAGE, AND BY ASSISTING GOP CAMPAIGN TO REVIVE PORTUGUESE TOURIST INDUSTRY.

15. WOULD APPRECIATE COPY OF PAPER SUBMITTED TO NSC AND REPORT OF DISCUSSION ASAP.

16. AMBASSADOR REVIEWED AND CLEARED DRAFT OF ABOVE CABLE BEFORE HE DEPARTED POST.
MKUN UNQUOTE KISSINGER

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